***Guardian Investment Corporation v. Commissioner, 44 B.T.A. 24 (1941)***

A taxpayer cannot deduct a debt as worthless under Section 23(k) of the Revenue Act of 1938 solely because a bank examiner ordered it to be charged off if the taxpayer has not independently ascertained the debt to be worthless.

**Summary**

Guardian Investment Corporation sought to deduct $200,001 from its 1939 gross income, representing a portion of a building corporation's debt charged off on its books following a bank examiner's order. Guardian argued the debt was not actually worthless and would eventually be repaid. The Board of Tax Appeals denied the deduction, holding that Section 23(k) of the Revenue Act of 1938 requires the taxpayer to independently ascertain the worthlessness of the debt, not merely comply with a regulatory order. Additionally, the Board questioned whether the debt, originating from a restructuring of Guardian's investment in its wholly-owned subsidiary, qualified as a deductible debt at all.

**Facts**

- Guardian Investment Corporation held a $600,000 note from its wholly-owned building corporation subsidiary.
- This note stemmed from a restructuring of Guardian's investment in the subsidiary, not from a cash loan.
- In 1939, a bank examiner ordered Guardian to charge off $200,000 of the building corporation's debt.
- Guardian complied with the order but maintained that the debt was not actually worthless and would eventually be repaid in full.

**Procedural History**

Guardian Investment Corporation claimed a deduction on its 1939 tax return. The Commissioner disallowed the deduction. Guardian appealed to the Board of Tax Appeals.

**Issue(s)**

1. Whether a taxpayer can deduct a debt as worthless under Section 23(k) of the Revenue Act of 1938 solely because a bank examiner ordered it to be charged off, without the taxpayer independently ascertaining the debt's worthlessness.
2. Whether the $600,000 indebtedness to the petitioner of the building corporation is such a debt as was contemplated by article 23 (k)-l of Regulations 101, as amended by Treasury Decision 4978, where the investment was merely changed into a note indebtedness.

**Holding**

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1. No, because Section 23(k) requires the taxpayer to ascertain the worthlessness of the debt, and compliance with a bank examiner's order does not satisfy this requirement if the taxpayer does not independently determine the debt to be worthless.
2. The court did not explicitly rule on this issue, but questioned if the alleged debt should be considered a debt under the tax code, since it resulted from a stock conversion and not a true lending arrangement.

**Court's Reasoning**

The Board of Tax Appeals focused on the language of Section 23(k) of the Revenue Act of 1938, which allowed deductions for "debts ascertained to be worthless and charged off within the taxable year." The court emphasized that the *taxpayer* must ascertain the worthlessness. Merely following a bank examiner's order, without an independent assessment of the debt's value, was insufficient. The Board also cited *Higgins v. Smith, 308 U. S. 473*, suggesting the government could "look at actualities" and disregard the form of the transaction (the creation of the note) if it was a "sham." While not explicitly ruling on this point, the Board questioned whether the debt arising from the restructuring of the investment qualified as a bona fide debt for deduction purposes. The court noted that Section 23(k) was amended by Section 124 of the Revenue Act of 1942, which abrogated Article 23(k)-1 of Regulations 101. The court reasoned, "Since that provision of the law has now been amended by section 124 of the Revenue Act of 1942, it must be held that article 23 (k)-l of Eegulations 101 has been abrogated."

**Practical Implications**

This case clarifies that taxpayers, especially those subject to regulatory oversight, cannot automatically deduct debts simply because a regulator mandates a write-off. They must independently assess the debt's worthlessness and document that assessment. The case suggests that the IRS can scrutinize transactions between related parties to determine if they are genuine debts or merely attempts to create artificial tax deductions. It also highlights the importance of staying current with changes in tax law and regulations, as amendments can significantly alter the deductibility of certain items.

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